MOTION FILED
OCT 15 1986

No. 86-422

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS,
and R. FOSTER WINANS,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

WILLIAM J. FITZPATRICK
GERARD J. QUINN
Securities Industry Association, Inc.
120 Broadway
New York, New York 10271
(212) 608-1500

TABLE OF CONTENTS

PAGE

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* iii

TABLE OF AUTHORITIES v

BRIEF *AMICUS CURIAE* 1

PRELIMINARY STATEMENT 1

INTEREST OF *AMICUS CURIAE* 2

REASONS FOR GRANTING A WRIT OF *CERTIORARI* 3

SUMMARY OF ARGUMENT 3

ARGUMENT

I. THE OPINION OF THE SECOND CIRCUIT MAJORITY CONFLICTS WITH SUPREME COURT PRECEDENT 4

II. THE OPINION OF THE SECOND CIRCUIT MAJORITY CONFLICTS WITH THE INTENT AND PURPOSE OF SECTION 10(b) AND RULE 10b-5 7

CONCLUSION 9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-422

DAVID CARPENTER, KENNETH P. FELIS,
and R. FOSTER WINANS,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Securities Industry Association, Inc. ("SIA") respectfully moves this Court, as *amicus curiae*, for leave to file the accompanying brief in support of the petition for a writ of *certiorari*. The consent of counsel for each of the petitioners herein has been obtained, but counsel for respondent United States of America has not consented to the filing of a brief by SIA as *amicus curiae*.

As set forth in more detail in the accompanying brief, SIA is the principal trade association of the securities industry, and is generally recognized as the spokesman for the securities industry in general and the broker-dealer community in particu-

lar. As such, SIA has an interest in this case, in which the court below expanded the coverage of the federal securities laws to redress breaches of the internal policy concerning business ethics of a private, non-securities related corporation, when neither the duty nor the injury are within the intended protections of the federal securities regulatory scheme. This holding, which also conflicts with Supreme Court precedent on the scope of Section 10(b) and Rule 10b-5, has caused confusion in the securities industry.

Wherefore, SIA respectfully requests that this Court grant its motion for leave to file the accompanying brief as *amicus curiae*.

Dated: October 15, 1986

Respectfully submitted,

/s/ WILLIAM J. FITZPATRICK

William J. Fitzpatrick
Gerard J. Quinn
Securities Industry Association, Inc.
120 Broadway
New York, New York 10271
(212) 608-1500

TABLE OF AUTHORITIES

Decisions PAGE

Cady, Roberts & Co., 40 S.E.C. 907 (1961) 4n

Chiarella v. *United States*, 445 U.S. 222 (1980) .....*passim*

Dirks v. *SEC*, 463 U.S. 646 (1983) .....5-6 & 5n

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976)..... 7

Santa Fe Industries, Inc. v. *Green*, 430 U.S. 462 (1977) 5n

SEC v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985) 6n

SEC v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*en banc*), *cert. denied*, 394 U.S. 976 (1969) ... 4n

United States v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986) .....*passim*

United States v. *Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (198[illegible]) 6n

Statutes and other Authorities

15 U.S.C. § 78j(b) [Section 10(b) of Securities Exchange Act of 1934] .....*passim*

17 C.F.R. § 240.10b-5 [SEC Rule 10b-5] .....*passim*

S. Rep. No. 47, 73d Cong., 1st Sess. (1933) 7

SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., 237-38 (1963) 7-8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-422

DAVID CARPENTER, KENNETH P. FELIS,
and R. FOSTER WINANS,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF *CERTIORARI*

PRELIMINARY STATEMENT

Securities Industry Association, Inc. ("SIA") submits this brief as *amicus curiae* in support of petitioners, and urges this Court to issue a writ of *certiorari* to the United States Court of Appeals for the Second Circuit with respect to the opinion below in *United States* v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986) (per Pierce, J. and Mansfield, J.). Pursuant to Rule 36.1 of the rules of this Court, the written consent of petitioners David Carpenter, Kenneth P. Felis and R. Foster Winans has

been obtained. Consent of respondent United States of America has not been granted.

INTEREST OF SECURITIES INDUSTRY ASSOCIATION, INC.

SIA is the principal trade association of the securities industry, having as its members more than five hundred securities brokers and dealers transacting business both nationally and internationally. Its membership is responsible for over ninety percent of the securities brokerage business conducted in this country, and includes members of every national securities exchange, as well as securities firms that are not members of any exchange.

SIA's members service securities investors of every size and type and perform a complete spectrum of professional securities activities, including retail and institutional brokerage, over-the-counter market-making, underwriting and other investment banking activities, various exchange floor functions, and money management and investment advisory services. In the course of performing these functions, SIA's members execute thousands of securities transactions of all types each day and are constantly receiving and disseminating information in connection with these transactions. SIA and its members have been in the forefront of efforts to enforce the federal securities laws governing trading on inside information, and to prevent and detect the misuse of such information. Accordingly, SIA's members have a keen interest in understanding, with as much certainty as possible, the scope of the insider trading proscriptions in the federal securities laws that are the subject of the opinion below.

The uncertainty created by the opinion below presents substantial problems for SIA's members. SIA members are now unable to know with any certainty whether transactions that they effect may constitute a breach of some non-securities related duty owed by a client to a third party, which breach

may subject these members to criminal or civil liability under the federal securities laws. Thus, a third party, who is not even in the securities industry, may, because of its private decisions on internal corporate policy and business ethics, determine the scope of criminal liability under the securities laws. The problem is especially difficult for SIA's members to resolve when, as here, the information at issue does not fit within traditional concepts of material non-public information.

REASONS FOR GRANTING A WRIT OF *CERTIORARI*

SUMMARY OF ARGUMENT

The federal securities laws are intended to protect the investing public, not to enforce the ethical ideals of a newspaper. The Second Circuit, by predicating a securities fraud solely upon the breach of a journalist's duty to his newspaper, has expanded the reach of the federal securities laws beyond the intent of Congress and the requirements articulated by this Court, and has thus caused tremendous confusion in the securities industry. Unless this Court lays to rest the uncertainties engendered by the Second Circuit's opinion, there could well be substantial adverse effects upon this nation's capital markets. Brokers and dealers, and their employees, may be inhibited in their daily functions, thus hindering the free flow of information and the transaction of business that is crucial to the efficient working of this nation's securities markets. This is especially true because the government has apparently chosen to test novel and expansive theories of liability for securities fraud under statutes providing for criminal—rather than civil—penalties. SIA respectfully submits that the petition for a writ of *certiorari* should be granted in order to eliminate the substantial confusion, created by the opinion below, that now exists in the securities industry concerning the scope of the insider trading proscriptions in the federal securities laws.

ARGUMENT

I.

THE OPINION OF THE SECOND CIRCUIT MAJORITY CONFLICTS WITH SUPREME COURT PRECEDENT.

The opinion of the Second Circuit majority in this case conflicts with the holdings of this Court interpreting Section 10(b) and Rule 10b-5,[1] which limit the scope of these antifraud provisions to cases in which corporate insiders—or those with whom they are in privity—breach fiduciary duties by trading on material information not available to shareholders of the corporations with whom they trade.[2] In *Chiarella* v. *United States*, 445 U.S. 222, 230 (1980), this Court stated that Rule 10b-5 applies only where there exists "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction," and held that a financial printer who, because of his employment, obtained advance information of proposed

---

1 Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of" any rule promulgated by the Securities and Exchange Commission ("SEC"). SEC Rule 10b-5, in turn, broadly proscribes any act that "would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

2 The SEC itself, notwithstanding its recent attempts to expand the reach of Rule 10b-5, recognized the intended reach of the federal securities laws in its initial applications of the antifraud provision. In *Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961), the SEC explained Rule 10b-5 as follows:

> An affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders. We, and the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment.

See also SEC v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*en banc*), *cert. denied*, 394 U.S. 976 (1969).

takeover bids, owed no duty to the sellers of the securities that he purchased.

In *Dirks* v. *SEC*, 463 U.S. 646, 653 (1983), this Court reiterated the limitations on the scope of Rule 10b-5, holding that there must exist a specific relationship—direct or derivative—between the shareholders of the company affected by the securities transaction and the individual who trades on material non-public information.[3] Hence, this Court held that Dirks, a broker who obtained information from employees of Equity Funding that the company's assets were vastly overstated, was not liable under Rule 10b-5 for disclosing this information to certain of his clients prior to public dissemination of the news.[4]

And, in *Chiarella*, when this Court considered what is now known as the "misappropriation theory" of liability for securities fraud, it was done within these well articulated limits.[5] 445

---

3 Although the Supreme Court recognized that *Dirks* involved an "unusual" set of facts, it nonetheless stated that "the principle at issue here extends beyond these facts." 463 U.S. at 658 n.18.

4 In its oft-quoted footnote 14, this Court made clear that corporate insiders may include not only corporate officers, directors and large shareholders, but temporary insiders such as lawyers, investment bankers, accountants, consultants and others who have entered into a special confidential relationship in the conduct of the corporation's business and are given access to material non-public information solely for corporate purposes. 463 U.S. at 655 n.14.

5 This Court has not yet ruled on the viability of the "misappropriation theory", which has been the subject of much criticism. The fundamental flaw in the "misappropriation theory" is that a breach of duty to an employer or an employer's clients is not a "securities fraud" within the ambit of Rule 10b-5, which this Court expressly recognized in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977):

> To the extent that the Court of Appeals would rely on the use of the term 'fraud' in Rule 10b-5 to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction, its interpretation would, like the interpretation rejected by the Court in *Ernst & Ernst* [v. *Hochfelder*, 425 U.S. 185, 199 (1976)], 'add a gloss to the operative language of the statute quite different from its commonly accepted meaning.'

Misappropriation of information may be unethical, but it is not in all cases a fraudulent or deceptive act concerning the purchase or sale of securities.

U.S. at 235-36. The printing house in *Chiarella* was a *Dirks* "temporary insider" of the corporations who entrusted it with confidential information concerning proposed tender offers.[6] Yet that predicate is conspicuously absent here.

In this case no such relationship or duty existed between Winans and the sources of his information. None of the defendants here was a temporary insider, as this Court used that term in *Dirks*, and none possessed material non-public information relating to the issuers of the securities he traded. There is not even the suggestion that the corporate insiders who were Winans's sources of information acted at all improperly in divulging the information that was the subject of Winans's columns. The only non-public information at issue was *The Wall Street Journal's* publication schedules. The use or abuse of that information is not the sort of conduct Congress sought to address in enacting the federal securities laws. Indeed, unless a parity of information requirement, rejected by this Court in *Chiarella*, 445 U.S. at 231-33, is read into Section 10(b), there is no basis in the federal securities laws for the extension of those laws to the conduct at issue here.

The facts of this case fall well outside the boundaries set by Congress and this Court for liability under Section 10(b) and Rule 10b-5. The duty upon which criminal liability was based—Winans's non-securities related duty to his newspaper—is simply not a sufficient predicate for securities fraud under this Court's pronouncements in *Chiarella* and *Dirks*. Nor is it sufficient to support application of the "misappropriation theory" as contemplated by this Court in *Chiarella*.

---

6 Indeed, the prior applications of the "misappropriation theory" by the Second Circuit were based on this rationale. *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985) (breach of duty by employee of financial printer to clients who entrusted the printer with material non-public information concerning tender offers); *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983) (breach of duty by employee of investment bank to clients).

II.

THE OPINION OF THE SECOND CIRCUIT MAJORITY CONFLICTS WITH THE INTENT AND PURPOSE OF SECTION 10(b) AND RULE 10b-5.

The purpose of Section 10(b) and Rule 10b-5 is to protect the investing public from fraudulent practices in connection with purchases and sales of securities. *E.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194-95 (1976); *see* S. Rep. No. 47, 73d Cong., 1st Sess. (1933) (Securities Act of 1933). Yet, at every turn, the majority's decision in *Carpenter* seems at odds with this purpose. The only fiduciary duty involved—that owed by defendant R. Foster Winans to his employer, *The Wall Street Journal*—was not a securities-related duty but instead a duty based upon a private non-securities corporation's concern for its reputation. The party to whom Winans owed that duty—again *The Wall Street Journal*—was not a purchaser or seller of securities and had no interest in the securities purchased and sold by the defendants. Thus, the only harm involved—a potential injury to *The Wall Street Journal's* reputation for journalistic integrity—is not within the intended protection of the federal securities regulatory scheme. The information upon which the defendants traded—advance knowledge of the publication schedule of *The Wall Street Journal's* "Heard on the Street" column—was not related to the value of the securities defendants traded. In sum, neither the fiduciary duty breached, the potential injury, nor the information traded upon is within the zone of interest of the federal securities laws.

While SIA does not condone defendants' actions, the Second Circuit decision fails to appreciate that, with regard to Rule 10b-5, there may be "significant distinctions between actual legal obligations and ethical ideals" with respect to individuals and entities involved in the securities industry. SEC, Report of the Special Study of Securities Markets, H.R. Doc.

No. 95, 88th Cong., 1st Sess., 237-38 (1963). Even more troublesome, however, is the fact that the court below has extended the federal *securities* laws to cover a breach of *journalism* ethics. Predicating criminal violations for securities fraud upon breaches of business ethics—when the breach is not in itself a violation of law—is without basis in law or in public policy. By going even further and predicating securities fraud violations on a breach of ethics wholly unrelated to the securities industry, the court below has done violence to the language and purposes of Rule 10b-5.

The fact that there now exists a rule of law for securities fraud pursuant to which an employer (such as *The Wall Street Journal*) could trade on the very same information as its employees (such as Winans) *without* incurring liability cannot but cause tremendous confusion as to the scope of Rule 10b-5. Moreover, although this Court has flatly rejected the parity of information rule as contrary to the intent of the federal securities laws, *Chiarella*, 445 U.S. at 231-33, the opinion below effectively permits a private employer, because of its internal decisions on corporate policy, not only to require its employees to follow such a rule (which indeed it may do), but to determine whether its employees will be subject to criminal prosecution for securities fraud for failing to follow it (which no private entity should be allowed to do).

Information is the lifeblood of this nation's securities markets, and knowing exactly what types of information may be used in securities transactions—and when it may be so used—is crucial to the efficient operation of these markets. We agree with the dissent in *Carpenter* that Rule 10b-5 "never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper," 791 F.2d at 1037 (Miner, J., dissenting), and urge this Court to grant the petition for a writ of *certiorari* and to return Section 10(b) to its legislatively intended use.

CONCLUSION

For the reasons set forth above, SIA respectfully requests that the petition for a writ of *certiorari* be granted.

Dated: October 15, 1986

Respectfully submitted,

William J. Fitzpatrick
Gerard J. Quinn
Securities Industry Association, Inc.
120 Broadway
New York, New York 10271
(212) 608-1500